Supreme Court of the United States.

OCTOBER TERM, 1903.

THE GREAT WESTERN MINING AND MANUFACTURING COMPANY, by L. C. Black, Receiver,
Petitioner,

No.———. *vs.*

CHARLES A. HARRIS et al, Executors, etc., et al,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

To the Supreme Court of the United States:

The petitioner respectfully prays for a writ of *certiorari* to review the decree of the United States Circuit Court of Appeals for the Second Circuit, and annexes hereto a statement of the case and its grounds for petition. It files printed copies of the record in the Circuit Court of Appeals and a certified copy of the transcript of the proceedings in that court.

Horace Cleveland

of Counsel for the Petitioner.

STATEMENT OF THE CASE.

(1) WHAT THE CIRCUIT COURT OF APPEALS DECIDED.

The Circuit Court of Appeals for the Second Circuit decided in this case:

1st. That the United States Circuit Court for the District of Vermont had no jurisdiction of a suit brought *in the name of the Great Western Mining & Mfg. Co., a Kentucky corporation,* by the receiver of that company against a citizen of Vermont under the direction of the United States Circuit Court for the District of Kentucky; and,

2d. That, even if the court had jurisdiction of the suit, no cause of action was vested in the corporation to recover $75,000 of funds of the company, which the directors and officers had secretly and fraudulently abstracted, but that such cause of action was vested in the creditors, or the receiver as representing the creditors.

(2) THE SUIT.

The suit was brought in the name of the Great Western Mining & Mfg. Co., by L. C. Black, its receiver, in the United States Circuit Court for the District of Vermont at the direction of the United States Circuit Court for the District of Kentucky, by which court the receiver was appointed, September, 1892, in a general creditors' and foreclosure suit. (Rec., 263, 264; Exs. 107-A, 108, 109, pp. 198, 199.)

The suit was against B. D. Harris, formerly the president and a director and one of the largest stockholders of the company. It was sought by the bill to charge him as a director and officer of the company, for the fraudulent misappropriation of $75,000 of its funds to his own use and that of his co-directors, and also for other acts of malfeasance and negligence. (Rec., 4-8.)

The Great Western Mining & Mfg. Co. was a corporation organized under the laws of the state of Kentucky. Its authorized capital was $3,000,000. Prior to 1888 and 1889 only $200,000 had been issued, owned as follows:

B. D. Harris, [president and director].....600 shares.
G. D. Harris, [director].....600 shares.
John Carlisle, [secretary, treasurer and director]....440 shares.

George W. Carlisle, [director] ..... 300 shares.
Geo. W. Richardson, [vice-president and director] .. 52 shares.
Jas. C. Holden, [director] ..... 4 shares.
Loring Hinsdale, [director] ..... 4 shares.

Total ..... 2,000 shares.
(Exhibit, pp. 106, 118, 165.)

From 1883 till 1889 these gentlemen had filled these positions, and had operated the company, whose business was the mining of coal. By 1888 it was hopelessly in debt to the amount of $131,000.00. For this debt the Harrises and Carlisles were responsible by endorsement, and otherwise, to the extent of $120,000.00 (Ex. 2; Ex. 98, p. 97; Rec. 102, 103).

In this desperate condition of the company the idea was conceived by them in 1888 of making a loan of $300,000.00 by issuing bonds in that amount secured by mortgage. Negotiations were entered into for this purpose ,which lasted from some time in 1888 until the spring of 1889. Finally, through John Carlisle, of Cincinnati, O., the secretary and treasurer, an agreement was effected with Elliott, Johnson & Co., of Wilmington, Del., the terms of which were never formally embodied in any written instrument, but which are shown in the following correspondence.

(3) THE AGREEMENT.

(John Carlisle to B. D. Harris):

"April 1, 1889.

"I think now is the time to offer additional inducements either *in giving* stock or a guarantee to the one who subscribes the first $25,000. (Ex. 98, p. 88.)

(John Carlisle to B. D. Harris):

"CINCINNATI, April 13, 1889.

"In my hurried letter yesterday I do not know that I made matters plain. It is this: Messrs. Elliott, Johnson & Co. about one year since placed with the aid of Fisk, Hatch & Co., of New York, the bonds of the Shawnee Coal Co. of this city, who are mining two thousand tons per day. *The bonds were sold at a discount, but were sugared with an even amount of stock, dollar for dollar. They were confident if we would agree to this that they alone could float the loan. That would mean doubling our stock to which I strongly objected. At last I agreed subject to your approval to increase the capital stock to* $350,000.00 *or* $400,000.00 *and give* $150.000.00 *of stock with the bonds.*" (Ex. 98, p. 88.)

(Elliott, Johnson & Co. to John Carlisle):

"WILMINGTON, Del., April 18, 1889.

"MR. JOHN CARLISLE,
Cincinnati, Ohio.

"DEAR SIR: Your favor of the 16th received. We wrote you yesterday, which will cover what you request, but now restate that our plan is to undertake to float your bonds, provided the further examinations legal and engineering are favorable, without assuming any responsibility, *so that the bonds with 50 per cent. of the Great Western Mining & Mfg. Co.'s capital stock, as a bonus, will net you 85 per cent.* • • •

"Yours truly,
ELLIOTT, JOHNSON & CO."

(Ex. 16, p. 36.)

(John Carlisle, Sec'y., etc., to Elliott, Johnson & Co.):

"APRIL, 27 1889.

"MESSRS. ELLIOTT, JOHNSON & CO.,
Wilmington, Del.

"GENTLEMEN: At the meeting of the directors of the Great Western Mining & Mfg. Co., held on the 22d inst., your proposition, embodied in your letter of the 18th inst., undertaking to float the bonds of this company, so that *the same should net the company eighty-five per cent. of the par value thereof, providing fifty per cent. of the par value of the bonds in the stock of the company should also be transferred with said bonds;* and also provided that the results of further examination are favorable, was presented and accepted, and the secretary was directed to notify you of such action of the directors.

"This gives you the exclusive authority to negotiate the sale of the bonds of the company.

"Very truly yours,
"JOHN CARLISLE, Sec., etc."

(Ex. 79, p. 67.)

(B. D. Harris to John Carlisle):

"BRATTLEBORO, Vt., June 3, 1889.

"JOHN CARLISLE, ESQ.,

"DEAR SIR: • • • It was no part of our original plans with Elliott & Co. that we should engage in this business, and did not enter at all in our arrangement with them. *Our plan was to sell* $300,000.00 *bonds with a bonus of* $150,000.00, *stock outright, etc., for the net sum of* $255,000.00, *and not to buy at all.* • • •

"Very truly yours,
"B. D. HARRIS."

(Ex. 98, pp. 96, 97.)

(4) THE FRAUD.

As stated in Carlisle's letter to Elliott, Johnson & Co., the meetings of the above named stockholders and directors of the company were held on April 22, 1889. At the meeting of the stockholders the loan of $300,000.00 was authorized. The capital stock was also increased to $350,000, *but instead of directing that the increase should be issued to the purchasers of the bonds as bonus stock,* as agreed, the stockholders and directors proceeded to work a scheme to fraudulently misappropriate $75,000.00 of the loan. They had been contemplating such a course for some time.

August 11, 1888, John Carlisle had written to B. D. Harris, relative to the bond issue.

"Mr. Tyler is of the opinion the words '*necessary expenses and outlays*' will cover as he expresses it '*a multitude of sins*' *and enable us to use the money received from sale of bonds, that is, what is left over and above paying the debts and working capital*" (R. 185).

On August 16, 1888, he had written to G. D. Harris, the brother of B. D. Harris, a letter intended for both, in which apropos of the use of funds derived from the sale of the bonds he had said:

"*After all this is done I think there will be left sufficient to divide that will almost refund to us what our stock cost us,* $70,000." (R. 186, 189, 192, 195, 196, 199, 204.)

And B. D. Harris in a letter to John Carlisle, April 27, 1889, referred to the matter as "our one chance." (Ex. 98, p. 90.)

The resolution of stockholders, passed April 22, 1889, to carry out the scheme of fraud was this:

"The attention of the stockholders being called to the large amount of net earnings being used for construction and betterments, the following resolution was presented, and, after consideration, was adopted, to-wit:

"WHEREAS, There has been expended for permanent improvements and betterments, including machinery, barges, flats, etc., during the years 1884, 1885, 1886, 1887 and 1888, more than $160,000.00, all of which sum has been furnished from the net earnings of the company and fairly belongs to the stockholders of the company.

"THEREFORE, RESOLVED, That the directors of this company be and hereby are authorized and requested to direct the Presi-

dent and Secretary of the company to issue one thousand shares of the capital stock of the company to be divided pro rata among the present stockholders of this company as follows:

To B. D. Harris	300 shares.
G. D. Harris	300 shares.
John Carlisle	220 shares.
G. W. Carlisle	150 shares.
George S. Richardson	26 shares.
James C. Holden	2 shares.
L. Hinsdale	2 shares.

(Rec. 152; Ex. 13, p. 12; Ex. 106, p. 177.)

These same stockholders and directors had in January, 1888, about the time the issue of bonds was first contemplated, issued to themselves $50,000,000 of stock in the same way, upon the pretense that $64,666.44 had gone into betterments during 1885, 1886 and 1887. (Rec. 151, Ex. 10, p. 10; Ex. 106, p. 172.)

On the same day, April 22, 1889, the directors, pursuant to the authority granted them at the stockholders' meeting, passed the following resolution:

"ASHLAND, Ky., Apr. 22, 1889.

"A meeting of the newly elected directors of the Great Western Mining & Manufacturing Company was held this day, immediately after the adjournment of the stockholders' meeting.

* * * * * * * * *

"The following preamble and resolutions were presented, and, after full consideration, were unanimously adopted, to-wit:

"'Whereas, The Great Western Mining & Manufacturing Company of Kentucky has power under its charter to borrow money and issue bonds therefor, and secure payment of the same by the mortgage of all or part of the property of the company; and

"'Whereas, At a meeting of the stockholders of the said company, held on the 22d day of April, A. D. 1889, the directors were authorized and requested to negotiate a loan of three hundred thousand dollars ($300,000), and to issue bonds therefor, and to execute a deed of trust or mortgage to secure payment thereof, on all the property of said company; and

"'Whereas, It is desirable to more thoroughly develop and to largly increase the output of the mines at Peach Orchard, and such development can not be secured without additional capital for the opening of new mines, for the purchase of additional machinery and working plant, and for the increase of terminal facilities; therefore

"'(1) RESOLVED, That this company will issue three hundred (300) mortgage bonds of the denomination of one thou-

sand dollars ($1,000) each, to mature in twenty (20) years from June 1, 1889, and to bear interest at the rate of six per cent. per annum, payable semi-annually, etc., etc.

" '(2) RESOLVED, That the payment of the three hundred bonds aforesaid as they respectively mature, and of the interest as it semiannually becomes due and payable, shall be secured by a first mortgage or deed of trust, conveying to the Mercantile Trust and Deposit Company of Baltimore, Md., all the property, real, personal and mixed, of the Great Western Mining & Manufacturing Company, etc., etc.

" '(3) RESOLVED, That said deed of trust shall provide for the creation of a sinking fund in 1894, etc., etc.

" '(4) RESOLVED, That the said deed of trust shall provide especially against the creation of any further mortgage debt, etc., etc.

" '(5) RESOLVED, That the preparation of the bond and deed of trust, in conformity with the foregoing resolutions, shall be entrusted to John Carlisle, and that the same, when duly approved by B. D. Harris, President, shall be executed, etc., etc.

" '(6) RESOLVED, That the president and secretary of the company shall arrange for the sale of the three hundred (300) bonds aforesaid, in their discretion, at the best price obtainable, *and the proceeds thereof shall be applied* to the cancellation and retirement of sixty (60) first mortgage seven per cent. bonds, dated Jan. 1, 1884, now outstanding; also to the payment of all floating indebtedness incurred up to the date thereof, for material and construction, and the balance shall be used by the directors for the best material interests of the company.' " (Ex. 14, p. 16; Ex. 106, p. 178-180.)

This resolution had been submitted to Elliott, Johnson & Co. by John Carlisle April 15, 1889 (Ex. 72, p. 64), and returned by Elliott, Johnson & Co. to John Carlisle April 17, 1889, in a letter in which they had stated that *"also other resolutions should be passed covering the issuance of stock and the fifty per cent. bonus."* (Ex. 18, p. 36.)

The directors at the same meeting, April 22, 1889, passed also this resolution:

"WHEREAS, at the annual meeting of the stockholders of this company, a resolution was adopted requesting the directors to issue additional capital stock of this company to the amount

of $100,000.00 to be divided pro rata among the present stockholders and *based upon the fact* that during the last five years more than $160,000.00 of the net earnings of the company have been expended for permanent improvements and betterments, thereby adding that amount to the assets of the company which belong to the stockholders of the company.

"THEREFORE, RESOLVED, That the president and secretary of this company are hereby directed to issue one thousand shares of the capital stock of the company to the present stockholders in proportion to the amount of stock already owned by them respectively, and that they furnish certificates of such stock as follows:

To B. D. Harris	300 shares.
G. D. Harris	300 shares.
John Carlisle	220 shares.
G. W. Carlisle	150 shares.
Geo. S. Richardson	26 shares.
James C. Holden	2 shares.
Loring Hinsdale	2 shares.

(Ex. 14, p. 16; Ex. 106, p. 178-180; Rec., 151, 152, 164, 165).

The only word Elliott, Johnson & Co. got of these resolutions of the directors dividing capital stock among themselves was this statement in a letter from John Carlisle:

(John Carlisle to Elliott, Johnson & Co., April 27, 1889). (Ex. 80, p. 67.)

"MESSRS. ELLIOTT, JOHNSON & CO.,
Wilmington, Del.

"GENTLEMEN: * * * I enclose herewith an official formal acceptance of your proposition.

"At our meeting of the 22d inst. we increased the capital stock to $350,000." * * *

"Yours truly,
"JOHN CARLISLE."

The recitals supposed to justify the distribution of this stock among these directors and officers as stockholders were absolutely false and known by them to be false. No net earnings had gone into betterments at any time between 1883 and 1889. The history of the financial condition of this company between those years (Ex. 2, p. 1-8) *prepared by John Carlisle for the information of the stockholders, and directors at these very meetings* as Carlisle reluctantly admitted, shows this fact beyond question. (Ex. 2, pp. 1-8; Rec. 101-114; Opinion of Wheeler, J., Rec. 280.)

On April 27, 1889, the very day Carlisle sent the formal acceptance of the company to the proposition of Elliott, Johnson & Co., to float the bonds with fifty per cent. of the stock as a bonus so that the same should net the company eighty-five cents of the par value thereof, and told them the capital stock had been increased for that purpose, he wrote this letter to B. D. Harris, the defendant in this case.

(John Carlisle to B. D. Harris):

"APRIL 27, 1889.

"I have yours of the 24th. I enclose letter received to-day from Elliott, Johnson & Co. with a copy of my formal acceptance of their proposition. I believe they can do much better, if not hampered with conditions.

"I also enclose a proposition of the stockholders *which Mr. Tyler carefully prepared so that we could legally take the* $75,000.00." (Ex. 98, p. 90.)

The proposition of the stockholders, which was enclosed, is as follows:

"Proposition of Stockholders of The Great Western Mining & Manufacturing Company to the Directors of Said Company.

"WHEREAS, the Directors of the Great Western Mining & Manufacturing Company have taken steps to borrow the sum of $300,000.00 to be used in payment of existing indebtedness of the company and to *provide additional working capital, etc.*, and have authorized the President and Secretary to execute bonds for said amount, and to negotiate the same at the best price obtainable;

"AND WHEREAS, *we are informed* that it will probably be possible to find purchasers for said bonds at the price of eighty-five per cent. of the par value thereof, provided that stock of the company, to the extent of fifty per cent. of the par value of the said bonds, shall also be transferred to the several purchasers of said bonds;

"AND WHEREAS, it is *deemed to be inexpedient to issue any new stock of the company for such purpose;* and *desiring to do all we can to assist the directors in procuring said loan and the sale of said bonds:*

"WE THEREFORE make this proposition to the directors of the company in reference *to the sale of stock held by us* in said company, *to the purchasers of the said bonds*, to-wit:

"We will sell to the several purchasers of said bonds of the company, stock of the company belonging to us, in the amounts set opposite to our names respectively, and will furnish to the secretary of the company certificates of said stock, as-

signed in blank, to be by him delivered to said purchasers of said bonds, upon the understanding and agreement, that we are to receive the sum of $50.00 for each share of stock so sold by us, out of the money paid for said bonds and said secretary shall act as our agent in receiving said amounts, and shall pay us the same, before the company shall be entitled to have the remainder of the money *paid for said bonds* by the puchasers thereof.

This action is not to be construed as a proposition to sell said stock to the company, but *it is to be treated and regarded as a sale of stock directly to the purchasers of said bonds, to be paid for by them to us, and the payment by them to the secretary of this company, for said bonds, shall be regarded as a payment to us for said stock, to the extent necessary to pay us therefor upon the terms above stated.*

"In Testimony Whereof we have hereunto set our hands, on this third day of May, 1889.

B. D. Harris	450 shares.
G. D. Harris	450 shares.
John Carlisle	336 shares.
Geo. S. Richardson	39 shares.
G. W. Carlisle	225 shares.
Total	1,500 shares."

It was signed by all the then stockholders, except Hinsdale and Holden, submitted to *themselves* as directors on May 13, 1889, long after the contract to sell the bonds *with the bonus of stock* so as to net the company eighty-five cents on the dollar had been made (Ex. 93, p. 96; Ex. 106, pp. 181, 182).

It is needless to say that it was not communicated to Elliott, Johnson & Co. Neither they nor any purchaser of bonds and bonus stock, although the Circuit Court of Appeals in its opinion suggests that no one was deceived, knew of it until 1894, when L. C. Black, the receiver, discovered it from the books and records of the company. (Rec. 165, 29-36; Ex. 108, p. 196.) This evidence is uncontradicted.

(5) THE RESULT.

Elliott, Johnson & Co. proceeded in good faith to dispose of the bonds with the bonus of stock, according to their contract, to divers persons. As they sold the bonds they remitted to the company for 85 per cent. of the face value thereof, beginning June 3, 1889, and gave the names of the purchasers to whom the supposed bonus stock at the rate of fifty cents of stock

for every dollar of bonds sold should be issued by the company. (Ex. 41, 42, 43, 31, 32, 33, 36, 37, 40, 46, 47, 49, 50, 55, 61, 62, pp. 50, 51, 44, 47, 46, 48, 49, 52-56, 59.)

John Carlisle, who was secretary and treasurer of the company at Cincinnati, upon receipt of their letters surrendered stock of his own or of his brother and issued new certificates in the names of the purchasers and forwarded them to Elliott, Johnson & Co. Later the matter was equalized by the Harrises and Richardson surrendering their quota of stock to Carlisle. (Rec. 193, 195; Ex. 15, p. 17.)

Long after these new stockholders had thus been brought into the company, Carlisle as treasurer of the company paid out of the proceeds of the bonds remitted to him, in accordance with the secret plan of the stockholders and directors of April and May, 1889, the $75,000.00 as follows:

B. D. Harris	$22,500.00
G. D. Harris	22,500.00
John Carlisle	16,800.00
G. W. Carlisle	11,250.00
Geo. S. Richardson	1,950.00
	$75,000.00

(Rec. 173, 193, 194.)

The result of the transaction as shown by the books of the company under date of April 1, 1890, is as follows:

Dr.	
Proceeds of sale of bonds at 85 cents	$255,000.00
Accrued interest	891.25
	$255,891.25

Cr.	
Bond expense—Prof. Weatherby and fee	$ 350.00
Bond expense—Mercantile Trust Co.	300.00
Bond expense—H. B. Huey, attorney	100.00
Bond expense—notary	4.00
Bond expense—registering bonds	60.00
Bond expense—lithographing	196.00
Bond expense—blue print maps	10.00
Bond expense—E. Vernon, drawing papers, etc.	480.00
Bond expense—printing	20.00
Bond expense—R. Tyler, attorney	250.00
Bond expense—telegrams	5.00

Bond expense—traveling expenses.....	500.00
Bond expense—Harris, Carlisle et al, stockholders	75,000.00
Firt mortgage bonds.....	60,000.00
John Carlisle, balance due Jan. 1, 1889, and int. 1 year	5,416.37
John Carlisle, treasurer, balance due Jan. 1, 1889, and int. 1 year.....	21,156.57
John Carlisle, 1st note.....	12,720.00
John Carlisle, 2d note.....	12,000.00
John Carlisle, 3d note.....	12,771.96
John Carlisle, 4th note.....	7,000.00
John Carlisle, interest on said notes....	3,392.61
John Carlisle, commissions.....	8,779.50
Total	$220,603.01
Balance left	$ 35,288.24

(Rec. 168, 172; Exs. 94. 95, 96, pp. 77, 85.)

That was all that was left out of $255,891.25, after paying the expenses of issuing the bonds, the $75,000.00 misappropriated by the directors and the debts of the company.

This balance of $35,288.24 was credited to "Treasurer's Account" and charged to "John Carlisle, Treasurer" Account, March 31, 1890, in two items of $30,000.00 and $5,228.24, respectively. It was afterwards used to pay dividends and interest

September, 1892, a receiver was appointed. Claims were filed and allowed by the United States Circuit Court for the District of Kentucky as follows:

Unsecured floating debt .....$	96,650.91
Bonded indebtedness with interest.....	318,675.00
	$415,325.91

The entire assets of the company sold for the following:

Mines, real estate, improvements.....	70,000.00
Goods in store	5,666.67
Total realized	$75,666.67

This entire indebtedness accumulated between 1889 and the failure of the company in September, 1892. (Rec. 219; Ex. 107-A, p. 195; Ex. 110, pp. 199, 210; Ex. 111, pp. 210 to 220; Ex. 112, p. 220 to 222; Ex. 113, pp. 223, 230.)

Up to the failure of the company, in September, 1892, and thereafter, B. D. Harris, his brother G. D. Harris, John Carlisle, his brother Geo. W. Carlisle, Geo. S. Richardson, Loring Hinsdale and James C. Holden, who had, with the exception of Holden, perpetrated this fraud, continued to be the sole directors and officers of the company in charge of its affairs, as they had been from 1883 to 1889.

(6) THE HOLDINGS OF THE COURTS BELOW.

The Circuit Court for the District of Vermont found that the estate of B. D. Harris, he having meanwhile died, was liable to account for $15,000.00 being the amount abstracted by Harris from the company in exchange for the three hundred shares of stock issued to himself in April, 1889, at the time the loan was floated; but held that his estate was not liable for the remainder of the $22,500.00, or $7,500.00 taken by him in exchange for stock issued to him in January, 1888, before the negotiations for the loan were concluded; and also held that his estate was not liable to account for the remainder of the $52,500.00 taken by the other officers and directors and stockholders with his connivance and consent. The court seemed to think that had the Harrises and Carlisles legitimately owned the stock, the transaction would have been perfectly regular, whereas had the stock been really their own, it would have been equally a fraud on the company to have applied it to such a use with such a purpose.

On cross appeals to the United States Circuit Court of Appeals for the Second Circuit, the appeal of the Harris estate was allowed, and the decree of the court below reversed with instructions to dismiss the bill on two grounds:

1st. That the United States Circuit Court for the District of Vermont had no jurisdiction of the suit brought in the name of the Great Western Mining & Mfg. Co. by its receiver;

2d. That even if the court had jurisdiction, the suit could not be maintained either by the corporation or in the name of the corporation by the receiver, because all the stockholders interested in the company at the time of the distribution of stock in April, 1889, and the sale thereof at fifty cents on the dollar under the proposition to the directors of May 3, 1889,

had assented thereto except Holden, who only owned a few shares.

I.

THE JURISDICTION OF THE UNITED STATES CIRCUIT COURT FOR THE DISTRICT OF VERMONT.

The Circuit Court of Appeals for the Second Circuit upon the question of jurisdiction cited the following cases:

Booth v. *Clark* 17 How., 322.
Hale v. *Allison*, 188 U. S., 56.
Evans v. *Nellis*, 187 U. S., 271.
Fennick v. *Guy*, 189 U. S., 335.
Heilliker v. *Hale*, 117 Fed., 220.

These cases simply decide that a receiver appointed by the court of one state could not maintain a suit in a court of another state, *in his own name*, to recover assets of a corporation or to enforce the double liability of stockholders.

Without any other reason than the reasons behind those cases, the Circuit Court of Appeals for the Second Circuit said:

"We think these considerations apply with equal force to the right of the receiver to maintain its suit *in the name of the corporation.* * * * But if said court can not send such an agent outside of its territorial limits to collect moneys as receiver, its attempt to exercise extra territorial powers, by directing such agent to proceed in the name of the corporation, must be equally futile except where the court by statute, or otherwise, is empowered to vest title in the receiver, or where the corporation or the court acting *within the powers on behalf of the corporation, or as the successor of its officers, has authorized such act.*".

Why the court in collecting the assets of a corporation is not acting within its powers, on behalf of the corporation, or as the successor of the officers of the corporation in suing in its name, is not explained. It certainly authorized the suit (Ex. 107*a*, 108, 109, pp. 198-199). It also most certainly did the same thing in principle as was done in *Great Western Telegraph Co.* v. *Purdy*, 162 U. S., 329, where the court made a call on stockholders to pay an assessment and directed the receiver to sue for it in the name of the corporation.

The court distinguished *Glenn* v. *Marbery*, 145 U. S., 499, in which Glenn, a trustee of a Virginia corporation, had brought

a suit *in his own name* in the District of Columbia to recover from Marbery an amount due on a call for subscriptions of stock made by the court, and where this court had said,

(Page 511): "There is no reason why the trustee, Glenn, could not have sued in the name of the company" on the ground that the title to the assets of the corporation vested in Glenn as successor of trustees named by the corporation.

It failed to give any weight to the fact that in *Great Western Telegraph Company* v. *Purdy*, 162 U. S., 329, a receiver appointed by the Circuit Court of Cook County, Illinois, brought an action *in the name* of the Great Western Telegraph Company, a corporation of Illinois, by himself as receiver, against Purdy, a citizen of Iowa, to recover a sum alleged to be due from him to the company under his subscription to its stock; and that the jurisdiction of the District Court of Des Moines, Iowa, where the suit was brought, was not called in question either in the state courts or in this court.

For some reason it ignored utterly the case of *Hayward* v. *Leeson*, 176 Mass., 310, *a case where the question has been fairly raised and decided.*

In that case the receiver of the East Tennessee Land Company appointed in a creditor's action by the Circuit Court of the United States for the Southern Division of the Eastern District of Tennessee, on the authority of that court instituted an action in the courts of Massachusetts *in his own name* to recover from directors and promoters secret profits made by them without full disclosure of the fact to the future stockholders about to be taken into the company. The Supreme Court of Massachusetts, while holding that the receiver could not bring the suit in his own name, said,

(Page 324): "The last objection made by the defendants is the plaintiff, as receiver, can not bring the suit in his own name; and we think that this objection is well taken. * * * The plaintiff, as receiver, by virtue of these orders, has the powers usually conferred by a court of equity upon a receiver to preserve property pending litigation and nothing more * * *."

(Page 326): "*Upon substituting the East Tennessee Land Company as plaintiff in place of John K. Hayward*" (the receiver), "the causes are to stand for hearing as to what the net profits are, which the defendants have respectively received,

or as to what the damages are, which the plaintiff has suffered, as the plaintiff shall elect to proceed for the property or its proceeds on the one hand, or for damages on the other hand." [Italics ours.]

This last case is not only an authority upon the question of jurisdiction but also upon the other questions involved.

Upon the vexed question of the right of a receiver to sue even in his own name out of the jurisdiction under the rule of comity it is not intended to enter.

Howarth v. *Angle*, 162 N. Y., 179.
Howarth v. *Lombard*, 175 Mass., 570.
Howarth v. *Elwanger*, 86 Fed., 54.
Holmes v. *Kirtley*, 107 Fed., 1, 9.
Lewis v. *Amer. Naval Stores Co.*, 119 Fed., 396.

However that may be, he can in collecting the assets, bring a suit *in the name of the corporation* under the authority of the court.

The contrary doctrine, as announced by the Circuit Court of Appeals for the Second Circuit, means that in every case where a receiver of a corporation is appointed having debts outside of the jurisdiction, ancillary proceedings for the appointment of a receiver will have to be brought in every State where there may be funds or property or claims of the corporation, in order to enable a suit to be brought; especially where, as in this case, the board of directors of the corporation at the time of the insolvency are themselves debtors of the corporation, and hostile to the receivership.

It is an important question involving the administration of the affairs of the majority of corporations which go into the hands of receivers. It should, we submit, be passed upon by this court.

II.

THE RIGHT OF ACTION TO RECOVER ON THE ONE HAND PROPERTY OF A CORPORATION, OR ITS PROCEEDS WHICH HAVE BEEN MISAPPROPRIATED BY OFFICERS OR ON THE OTHER HAND DAMAGES FOR ITS MISAPPROPRIATION, IS IN THE CORPORATION AND NOT IN ITS CREDITORS OR ANY ONE ELSE.

This proposition has been settled by this court.

Van Weel v. *Winston*, 115 U. S., 228, 245, 247.

Porter v. *Sabin*, 149 U. S., 473, 478.

This was not primarily a suit against B. D. Harris as a stockholder to recover $22,500.00 par value of stock which was issued to him as fully paid up, when he paid no consideration therefor. Such a cause of action, apart from the stock having been secretly distributed just before other stockholders were about to be taken in, as all the then stockholders, except Holden, assented, may be in the creditors.

Handley v. *Stutz*, 139 U. S., 417, 426-428.

Camden v. *Stuart*, 144 U. S., 104, 113-115.

It is not a suit brought on behalf of the bondholders and stockholders for fraudulent misrepresentation as to the value of the bonds or shares taken by them. Such right of action, we agree with the United States Circuit Court of Appeals, would only lie in favor of the creditors to whom the misrepresentations were made.

It is not strictly a suit against *stockholders as such* to annul the alleged contract made by them with themselves as directors under date of May 3, 1889, and to recover the consideration paid thereunder by which they in form pretended to sell stock to the purchasers of the bonds, but in reality turned it over to the corporation to issue to the purchasers of bonds as bonus treasury stock. If it were, it may be that the stock would have to be tendered back by the corporation.

It is a suit against a director and the president of the company, having in charge its funds, to ~~without consideration~~ charge him with $75,000.00, proceeds of a loan to and assets of the corporation, or what is the same thing, damages in that amount for taking the $75,000.00, which came into his hands and under

his control as an officer and director of the company, and which he, as charged in the bill, conspired with his co-directors to fraudulently appropriate to the extent of $22,500.00 to his own use and to the extent of $52,500.00 to the use of his co-officers and co-directors; and to consummate such fraud, adopted the plan, as charged in the bill, of issuing to himself and his co-directors $150,000.00 of stock without consideration, and of turning it back to the corporation at fifty cents on the dollar, under the pretense of enabling it to carry out its contract to sell $300,000.00 of bonds with $150,000.00 of treasury stock as a bonus at eighty-five cents on the dollar.

If the contract of May 3, 1889, between the stockholders and the directors be treated as anything more than a form, to help accomplish the abstraction of $75,000.00 it is maintainable as a suit to recover damages from a *director* for fraud in the sale of his and his co-directors' worthless stock to the corporation, which had $2,750,000 of the same worthless stock still in its treasury, to the damage of the corporation as representing all interested in it. The suggestion that the contract of May 3, 1889, was between the stockholders and purchasers is utterly untenable. It is not so in form. It is with the directors. It is not so in fact. The directors were not agents of the purchasers and had no such authority.

Yet the Circuit Court of Appeals for the Second Circuit seemed to entirely overlook and utterly misapprehend the nature of the action. It says:

"But even if it be assumed that this receiver, by thus bringing suit in the name of this corporation by himself as receiver, can maintain an action on its behalf which he could not maintain as receiver only, it is not clear how this assumption would help the plaintiff corporation. It is, in any event, bound by the rules of law regulating the relations of a corporation to its officers, and, between it and its stockholders and directors, by its contract and the acts done in pursuance thereof.

"A creditor, on the other hand, may by appropriate legal proceedings avail himself of every existing legal right against the corporate officers or stockholders. A contract between a corporation and its stockholders, that they should not be called on to pay therefor in full, is good between the corporation and its stockholders. The creditor defrauded by such a transaction may have such contract set aside. * * * So, too, a receiver, if duly authorized to institute such a suit is a representative of

all parties interested therein. He is appointed in behalf of all parties who may establish rights in the cause. (*Booth* v. *Clark, supra*).

"He may, as a representative of creditors, disaffirm acts of the corporation, and sue to set aside transactions entered into in fraud of their rights. * * *

"The complainant is bound by the allegations of the bill and the contention on which it is based, that this is a suit only in the right of the corporation independent of its creditors, and to which neither the receiver nor the creditors are parties. We are of the opinion that such a suit can not be maintained by this corporation. * * *

"It would seem that inasmuch as it was agreed as part of the contract between the corporation and its stockholders that the stock should be deemed fully paid the stockholder could not be held liable in a suit by the corporation wherein it seeks to annul its contract as a fraud upon the general creditors of the corporation. * * * We have then, in this case, a suit brought in the name of a corporation, wherein it seeks to repudiate, on the ground of fraud, certain contracts made by it with its officers and stockholders, which, so far as the record shows, was lawful in its inception. Whether it could in any case thus disaffirm its contract and seek to recover the fruits thereof without restoring the parties to their original status, it is not material to inquire. (*Scoville* v. *Thayer, supra.*)

"It is clear that it is not the proper party to maintain this suit.

"The corporation was a party to the contract whereby it was agreed that no payment should be required upon said issues of stock. The evidence shows that the bonds could not be floated without a stock bonus, and, there being no stock in the treasury of the company" (*sic*) "the stockholders contracted with said company to sell to the bondholders directly their own stock, pro rata, in order to provide such bonus. * * *

"In stating these conclusions we do not wish to be understood as holding that the transactions complained of may not have been grossly fraudulent, to the prejudice of certain creditors of the corporation; nor do we question the doctrine that the assets of an insolvent corporation are impressed with a trust for the payment of its debts and can not be withdrawn by the stockholders without providing for such debts, as held by the court below. Assuming the facts found by the court below, we think the receiver has misconceived his right and acted beyond the scope of his authority in thus bringing this suit in the name of the corporation."

In support of these propositions the Circuit Court of Appeals cites the well known cases of:

Scoville v. *Thayer*, 105 U. S., 143.
Clark v. *Bever*, 139 U. S., 96, 111.
Evans v. *Nellis*, 187 U. S., 271.
Handley v. *Stutz*, 139 U. S., 417.
Coit v. *Gold Amal. Co.*, 119 U. S., 343.
Hale v. *Allison*, 188 U. S., 56.

These cases have no application to the taking of the $75,000.

(1) *Scoville* v. *Thayer*, 105 U. S., 143, decides that there is no obligation on the part of the stockholders as between them and the company, where an agreement has been made by the company that no further assessments should be made, to pay for the residue of their stock, unless it became necessary to satisfy creditors, and that, therefore, the statute of limitations did not run until the necessity for the payment had been ascertained and an authorized demand of payment made.

(2) *Clark* v. *Bever*, 139 U. S., 96, decides that a corporation in good faith may pay its indebtedness, or sell or dispose of its stock in payment of debts to its creditors at less than par.

(3) *Evans* v. *Nellis*, 187 U. S., 271, decides that under the statutes of Kansas as interpreted by the Supreme Court of that state, only the receiver can bring an action against the corporation to collect the statutory liability of stockholders for the benefit of all creditors in an action against the corporation and all the resident stockholders, and, therefore, such receiver could not maintain an action in a Circuit Court of the United States against an individual stockholder for the amount of the statutory liability.

(4) *Handley* v. *Stutz*, 139 U. S., 417, decides that a stockholder who receives a gratuitous distribution of stock as fully paid, incurs an obligation to pay for it in full, when called upon to do so by creditors whose debts are subsequent to the increase; but that this equity does not exist in favor of a creditor whose debt was contracted prior to such authorization; and further that a corporation in good faith may give stock as a bonus with and in order to sell its bonds.

(5) *Coit* v. *Gold Amal. Co.*, 119 U. S., 343, decides that where shareholders honestly and in good faith pay for their subscription in property in place of money, third persons can not

complain; but where there is a gross and obvious overvaluation of property conveyed in consideration of an issue of stock, there is strong evidence of fraud in an action against a stockholder by a creditor to enforce personal liability for his debt.

(6) *Hale* v. *Allison*, 188 U. S., 56, decides that a receiver can not collect the double liability in a foreign jurisdiction under the laws of Minnesota; and also that the liability was one in favor of creditors, with which the corporation had nothing to do; and that the statute did not make the liability assets of the corporation, or confer upon any receiver appointed in a case the right to enforce it, especially without the jurisdiction of the court.

What have these cases to do with the case made by the bill and proof? This suit, as to the $75,000 taken, was not one against stockholders to recover unpaid subscriptions to stock or the value of stock which the stockholders in the Great Western Mining & Mfg. Co. issued to themselves; but was a suit to charge B. D. Harris because he, with others, was a director and officer of the Great Western Mining & Mfg. Co.; because as such director and officer he stood in a fiduciary relation to the corporation; and by reason thereof could not take a remuneration for stock, which as a director he had agreed to issue as bonus stock to effect a sale of bonds by secretly issuing the stock to himself and turning it back to the corporation at fifty cents on the dollar to supply to purchasers of bonds.

In other words, the company having agreed to sell bonds at eighty-five cents on the dollar with a bonus of stock, the directors and officers of this company could not, pending such negotiations and after the same were closed by contract, secretly issue to themselves as stockholders the amount of stock so agreed by the corporation to be given as a bonus and then secretly as stockholders go through the form of selling it to themselves as directors to enable the company to supply bonus stock to the purchasers of the bonds, though the company had $2,750,000 treasury stock on hand, and thereby take $75,000 of the proceeds of the sale of the bonds from the treasury of the company. They could not even have sold the stock which they legitimately owned in this way, much less that which they took in order to use in this illegitimate way.

Such a transaction was a fraud on the corporation. It was taking the money of the corporation. The money when paid

in by the bondholders for their bonds and bonus stock became the money of the corporation and general assets to be used for all purposes of the corporation (*Van Weel* v. *Winston*, 115 U. S., 228, 245). It did not continue to be the money of the bondholders who paid it. They, it is true, were defrauded both as bondholders and stockholders, because the assets of the corporation were depleted and so has every other creditor and stockholder of the corporation been defrauded for the same reason. But the $75,000 taken, if recovered, does not belong to any special class of creditors, but would be general assets of the corporation.

The directors and officers, at the time they made the contract with Elliott, Johnson & Co., to float the bonds at eighty-five cents on the dollar with a bonus of fifty cents of stock for every dollar of bonds stood in a fiduciary relation not only to themselves as the sole stockholders and the existing creditors of the company, but also to all the subsequent stockholders whom they contemplated bringing in, the purchasers of the bonds, and the future creditors of the company. They were much more than promoters, in reference to whom the rule as to secret profits and full disclosure is so strict. They were directors and officers of an existing corporation and *promoters* of a new loan and issue of bonus stock. Contrary to what the Circuit Court of Appeals said the company had an authorized capital stock of $3,000,000. It had only issued prior to 1889 $250,000. It had $2,750,000 of treasury stock on hand. It had a perfect right, if it were necessary to enable it to float its bonds, to increase its capital stock to any amount up to $3,000,000 and to issue the stock as fully paid as a bonus to enable it to float its bonds at eighty-five cents on the dollar.

Handley v. *Stutz*, 139 U. S., 417, 420, 435.
Dickerman v. *Trust Co.*, 176 U. S., 202.

This it agreed with Elliott, Johnson & Co. to do by increasing the stock to $350,000 or $400,000. But instead of doing so, these directors and officers "secretly and, therefore, dishonestly," as said in *Re Olympia, Ltd.*, L. R. (1898), 20 Chan., 153, same case *Gluckstein* v. *Barnes*, L. R. (1900), App. Ca., 240, issued to themselves $100,000 of the stock, and then turned it with $50,000 of stock they had issued to themselves in 1888 back to the company at fifty cents on the dollar and under this guise secretly took $75,000 from the treasury of the company.

III.

THE AUTHORITIES.

The cases relied upon by the petitioner are not mentioned in the opinion of the United States Circuit Court of Appeals. It may be we are wholly mistaken in their application, but we submit that they are precisely in point and analogous to the case at bar. One of them is the same sort of a case as this. They hold, not only that such a proceeding as the one complained of in this suit is a fraud, whether honestly or dishonestly intended, but *also that the right of action is in the corporation* as representing all interested in the company whether then actually in or intended to be brought in.

(1) *London Trust Co., Ltd.*, v. *Mackenzie*, 68 Law Times Rep., 380, is this case.

The directors of a company entered into an agreement with a firm of contractors to do certain work for the company for a specified sum in debentures and fully paid shares of the company and also made, secretly, certain contemporaneous agreements with the contractors to make over to third parties, without consideration, a certain portion of these debentures and shares. *Each of the shareholders and debentureholders who were in the company when this agreement was made* took a benefit under one or other of the contemporaneous agreements and *all agreed* to such disposition of the *debentures and shares*. The court said,

(Page 384): "The plaintiffs in substance claim a declaration that the defendants are liable to make good to the company the amounts of these appropriations as being in effect a giving away of capital of the company and beyond the powers of the directors.

"The more substantial defenses are two. First, it is said that the arrangement was one to which every one who had an interest either as a shareholder or debentureholder or creditor agreed, that no one was wronged or defrauded and that under the circumstances the case of *Re The Gold Mining Co.*, 11 Ch. Div. 701; *Re The Ambrose Lake Tin & Copper Co.*, 14 Ch. Div. 390, and *Re The British Seamless Paper Box Co.*, 17 Ch. Div. 467, apply and neither the company nor the plaintiff's shareholders could complain.

"But those were all cases of persons who owned the entire capital of the company *and intended to remain the sole pro-*

prietors, and they were held free to make honest agreements among themselves as to the appropriation of their property, whereas in he present case there was to be a large issue of shares to the contractors which it must have been intended that the public should take up, and there remained a large part of the share capital to be alloted in the future, and the parties to the present agreements were taking for themselves thirty thousand pounds of the company to the detriment of all who might take any such shares, and they were doing so secretly and were misrepresenting by the prospectus and registered deed the real nature of the transaction.

"It seems to me *the company is entitled to protect the future shareholders and its own funds against such appropriation* and that the very cases relied on by the defendants are authorities for this view. 'If,' said James, L. J., in the last cited case, 'they were intending although then constituting the whole company that other people should come in afterwards to whom what had been done would be injurious the court would feel no difficulty in saying as Lord Langdale did in *The Society of Practical Knowledge* v. *Abbott,* 2 Beav., 559, that they intended to commit a fraud.' "

And again,

(Page 385): "Mr. Masterman drew a distinction which does not appear to be tenable. It was *qua* shareholder not *qua* director, he said, that he stipulated for the bonus as a condition of giving his consent. But as director he gave a profit to himself as shareholder and the director must account for it. * * *

Objections were raised to the right of the plaintiffs to maintain this action. .So far as the company is concerned it is for the reasons already given entitled to sue in the interest of those who hold the shares issued to the contractors or to be issued to the public." (Italics ours.)

(2) *Hayward* v. *Leeson,* 176 Mass., p. 310, covers all the points raised by the defense in this case. In that case directors of a corporation, who, before any capital stock had been issued to the public, caused to be issued to themselves, as a remuneration for their services as promoters and for options on land, by the vote of all persons who then had any interest in the corporation, one-third of the whole capital stock and then invited subscriptions to the stock without disclosing that fact, were held:

(*a*) Guilty of a fraud;

(*b*) Liable in a suit in equity (which should in a foreign jurisdiction be brought in the name of the corporation and not

in that of the receiver) to account for the net profits received by them; or damages suffered by the company;

(*c*) At the option of the company as it chose to follow the shares or the proceeds thereof or to recover damages;

(*d*) And had no right to demand that the company tender back the lands acquired by it under the options transferred in exchange for the stock.

The court said—in answer to the contentions; that the stock issued was lawfully issued for interest in lands and for services rendered or to be rendered; that there was no fraudulent overvaluation in the issue of the $700,000 shares of stock; that the issue of the stock was voted for by the defendants and others as stockholders, and that stockholders are under no fiduciary relation to anybody and can do as they will with their own; and moreover that it was consented to by all the stockholders of the East Tennessee Land Company, and, consequently, could not then be made the basis of any complaint by the corporation or anybody else;

(Page 318) "Moreover, it is not sought in these suits, to charge the defendants because they voted as stockholders to issue the $700,000 of stock; but it is sought to charge each defendant because he, with others, was a promoter of the East Tennessee Land Company; because as a promoter he stood in a fiduciary relation to the future shareholders of that corporation, and by reason thereof he could not receive any remuneration for his services as a promoter of that corporation without making a full disclosure thereof, and obtaining the consent of those shareholders thereto." (Citing cases) * * *

(Page 320): " * * * The person to whom the promoters owe the duty which they owe by reason of their fiduciary relation are the persons who put their money into the enterprise at the invitation of the promoters, that is to say, the future stockholders. It is to the future stockholders that the promoters must make the disclosure of the remuneration which is, or is to be, paid to them, and it is the consent of the future stockholders that must be obtained to make that payment valid; if the promoters undertake to make to themselves remuneration for their services as promoters without making a full disclosure of the fact to the future stockholders, their principals, and getting their consent, they are guilty of a fraud."

(Page 326): "Upon substituting the East Tennessee Land Company as plaintiff in place of John K. Hayward, the causes are to stand for hearing as to what the net profits are, which the defendants have respectively received, or as to what the

damages are, which the plaintiff has suffered, as the plaintiff shall elect to proceed for the property or its proceeds on the one hand, or for damages on the other hand."

(3) The case of *Re The British Seamless Paper Box Co.*, 17 Ch. Div. 467, was one in which all the owners of shares in the company had allotted to themselves a large amount of stock without consideration. The company afterwards failed and the attempt was made to hold the stockholders for the shares so allotted.

In addition to what James, Lord Justice, said on page 476, quoted in *London Trust Co., Ltd.*, v. *Mackenzie, ante*, Brett, Lord Justice said:

(Page 478): "I agree that if shortly after such a transaction directors admitted new shareholders, it would be strong evidence that they intended at the time to take in new members, and unless all the circumstances are disclosed to them the directors might be made liable for misfeasance because it would be inferred that they intended to act for the future members as well as the present."

And again, Cotton, Lord Justice, said:

(Page 479): "We have not heard counsel on behalf of the respondent but subject to what they may aver I should have said that if this had been an ordinary company in which there was an intention to admit new members and offer the shares to the public, the official liquidator would have been entitled to call on the directors to account for the value of their shares. But on what principle? *It is that the directors stand in a fiduciary relation to the whole company, that is, not only to the existing members but to all whom they intend to bring in. A trustee can not make a profit for himself without the full knowledge of all his cestuis que trust, and so the directors of a company formed in the ordinary way stand in a fiduciary relation not only to those who are members at the time, but to all who may come in after.*" * * *

With reasoning such as this, the court would have had very little difficulty in holding directors liable, for issuing $150,000 of stock to themselves and using it to take $75,000 from the company, under an agreement made with themselves, after they had agreed to sell bonds and issue bonus stock, especially if they never really took the money until long after the bonds and stock had been issued and sold, and the new members were

in, and the money was taken from the proceeds of the very loan which had brought in the new members.

(4) Another English case is that of *In Re Anglo French Co-operative Society*, L. R., 21 Ch. Div., 492.

In that case the directors paid to a promoter £3,000 for expenses and for the discovery of a plan to float its debentures. The expenses were £400 and there was an understanding between the directors and promoters that the remaining £2,600 should be invested by the promoter in the debentures of the company to be floated. The £3,000 was paid to the promoter who retained £400 for expenses and bought of the company £2,600 of the debentures. The debentures so purchased were then divided according to arrangement between himself and the directors being all the persons interested at the time of the agreement in the company.

It was held that this was a clear misapplication of the £2,600 the funds of the company; *that the company could recover the full* £2,600 *from the directors;* that they were jointly and severally liable therefor; that the investment of the money in debentures of the company was not a repayment thereof to the company. Vice Chancellor Hall, who delivered the opinion of the court, said:

(Page 496): "No person who has any management or control of the affairs of a company, or who occupies any fiduciary position in reference to a company, can merely because such an agreement has been signed say that such a sum could be allowed as against the company or taken out of its assets.

"The amount itself shows that it was not a proper payment. As has been observed this was a company that was going on. It is not like the case of the *British Seamless Paper Box Co.*, 17 Ch. Div. 467, which has been referred to by Mr. Grosvenor Woods. It is not a case of that kind. The parties were in the position of owing a duty not merely to the persons who were then interested in the company *but to all persons who should afterwards be in the company.* It seems to me that this was a clear misapplication of the money of the company." (Italics ours).

The decision was affirmed on appeal.

(5) Another case is that of *Gluckstein* v. *Barnes*, L. R. (1900) App. Cas. 240, decided by the House of Lords on appeal from the Court of Appeals where it was reported as *Re Olympia Co., Ltd.*, L. R. (1898), 2 Ch. 153.

In that case a secret profit was made by directors and promoters of a company.

In the course of his judgment, Lord Chancellor Halsbury said:

(Page 247): "They were to be sellers to themselves as buyers, and it was a necessary provision to the plan that they were to be both sellers and buyers, and as buyers to get the money to pay for the purchase from the pockets of the deluded shareholders.

"My lords, I decline to discuss the question of disclosure to the company. It is too absurd to suggest that a disclosure to the parties to this transaction is a disclosure to the company of which these directors were the proper guardians and trustees."

Lord Macnaghton said:

(Page 248): "And then comes the last act. *Secretly, and therefore dishonestly, they put into their own pockets the difference between the real and pretended price.*

"After a brief career the company is ordered to be wound up. In the course of liquidation the trick is discovered. * * *

"Disclosure is not the most appropriate word to use when a person, who plays many parts, announces to himself in one character what he has done and is doing in another. To talk of disclosure to the thing called the company, when as yet there were no share-holders is a mere farce. *To the intended share-holders there was no disclosure at all.* On them was practiced an elaborate system of deception." (Italics ours).

Lord Robertson said:

(Page 257): "The directors of the company are its executive organ; to them its interests are confided and in the present instance the comp ny, even in this its inchoate stage, was identifiable through i executive.

"I hold that from the moment this step was taken the coming directors stood in a fiduciary relation to the company, whose interests were to be in their sole hands. This conclusion rests not on technical rules of law, but on the dictates of fair play embodied in law. *The people for whom these gentlemen were bound to act were their coming constituents, the persons out of whose money they proposed to make their gain.*" (Italics ours.)

(6) The case as reported below *Re Olympia Ltd.*, L. R. (1898), 2 Ch. 153, also contains some significant expressions.

Lord Lindley, in the course of his judgment, said:

(Page 167) "What effect then has such a knowledge of such persons *on the right of the company* to claim the profit thus

being made by its directors and promoters out of it? My answer is, none whatever, except to deprive the directors who share in the profits of all possible defense to such claims. To say that the knowledge of such persons of their own conduct, which from first to last they were doing all they could to conceal, is to be treated as the knowledge of the company or of the share-holders, is to say that which is opposed not only to commen sense, but also to well settled principles of law." (Italics ours.)

Rigby, L. J., said:

(Page 173): "There never was the slightest intention on the part of any one of the directors to do his duty to the company with reference to the transaction impeached; *they were only trying secretly as regards the main bodies of the subscribers for shares to weave a net of legal technicality which might hamper the company in its endeavors to get rid of the fraud attempted to be practiced.*" (Italics ours.)

Cotton, L. J., said,

Page 175: "The corporate entity towards which the duty exists is a thing apart from the seven individuals who for the time being are the only corporators, and the question whether disclosure to them will suffice or not, will depend on whether the constitution of the company is really such that they can be in fact contemplated *as exhausting all the persons whom the company is intended to embrace.* There may be a company such as is sometimes called a private company or sometimes a one man company *where by its very constitution no one is intended to have, and can not be contemplated as being about to acquire, an interest in the company except the signatories themselves.* In such cases the fiduciary obligation might not extend beyond such persons: See Salomon's Case, L. R. (1897) App. Cases, p. 22.

"But where, as here, the very pith and marrow of the whole venture is that cash to the extent of one hundred and eighty thousand pounds shall be subscribed by the public for the benefit of the promoters and directors, *the duty extends to all the persons who are to be contemplated as about to become purchasers.* There is abundant authority for these propositions." (Italics ours).

In this connection Cotton, L. J., cited:

Erlanger Case, L. R., 5 Ch. Div. 73, 113 123.

In re British Seamless Paper Box Co., 17 Ch. Div. 471, 477-8.

All these cases only apply the principles laid down as far back as *Hitchens* v. *Congreve* (1828), 4 Russ., 562. There are many other English cases to the same effect.

Phosphate Sewage Co. v. *Hartmond*, L. R., 5 Ch. Div. 394.

Broderlip v. *Salamon*, L. R. (1895), 2 Ch. 323, 329.

Broderlip v. *Salamon*, L. R. (1897), App. Cas., 22.

In Re Postage Stamp A. D. Co., L. R. (1892), 3 Ch., 566, 576.

American cases are also not lacking:

Dickerman v. *Northern Trust Co.*, 176 U. S., 181, 203, 205.

Hoffman Steel & Coal Co. v. *Cumbrland C. & I. Co.*, 16 Md., 456.

Cumberland Coal & I. Co. v. *Sherman*, 30 Barb., 553.

It is true some of these cases are promoter cases. Is there any difference between the duties of a promoter and a director except in degree? Which owe the higher duty to the company? Were not these directors promoters of this loan for the company? Could they secretly issue and sell it stock at a profit to themselves without disclosure? Were they not, as Rigby, J., says, by the agreement of May 3, 1889, never disclosed, "trying to weave a net of legal technicality, which might hamper the company in its endeavor to get rid of this fraud"?

Does it take any imagination to reach the conclusion that, had Elliott, Johnson & Co., and the purchasers of the bonds and bonus stock known, as the undisputed evidence is they did not know, that the directors of the company, who had agreed to sell them bonus stock and bonds at eighty-five cents on the dollar, intended to take $75,000 of the proceeds of the sale to their individual use, they would never have consented to the arrangement? Were not these directors and officers bound to deal fairly and honestly with those they intended to take into the corporation? Did and does not the corporation represent them?

Could they sell them bonus stock and bonds at eighty-five cents on the dollar, and then secretly reduce the assets of the corporation $75,000 by a private agreement between themselves as stockholders and directors to sell "bonus stock"—their stock—to the purchasers of bonds without the latter's knowledge! Were not Elliott, Johnson & Co., and the purchasers from them, entitled to be informed that the stockholders had agreed with the directors to sell stock to them at fifty cents on the dollar

and bonds of the company at sixty cents? Did it take any acquaintance with legal principles to apprise the Carlisles and Harrises that they were dealing unfairly with these purchasers, and that they were dealing with the funds of the corporation as if they were the only parties in interest? Was not their failure to disclose the agreement of May 3d, 1889, dishonest? Was not their secret taking, and therefore in the language of *Re Olympia, Ltd.*, "dishonest taking" of the $75,000 after these stockholders had come into the company, a gross fraud and misapplication of its assets?

Indeed it is difficult to see on what theory the transaction can be discussed. *The burden of proof was upon the defense to show entire good faith in the transaction and the fullest disclosure of all the facts to all who were actually or potentially interested.* Instead of that the complainant established by the mouth of one of the chief participants in the fraud the facts which show a deliberate, long-planned and successfully executed fraud upon those to whom he and his co-directors occupied a fiduciary relation, at a loss to the company of $75,000 of its assets. And yet the Circuit Court of Appeals says the corporation can not recover its own money.

IV.

CONCLUSION.

(1) In view of the important consequences of the decision as to the jurisdiction of a suit brought in the name of a corporation in a foreign jurisdicion by a receiver,

(2) And in view of what seems to us to be a manifest fraud and a misconception of the nature of the case by the Circuit Court of Appeals for the Second Circuit, we respectfully ask that a writ of *certiorari* be granted.

HARLAN CLEVELAND,
of Counsel for Petitioner.